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The Cost of Decommissioning: Government and Industry Attempts at Addressing Decommissioning Liabilities

A comment on the recent government consultation process and the launching of the industry Decommissioning Cost Provision Deed (DCPD) By Dr Leon Moller[] October 2007*

Background

With the decline of North Sea oil and gas production and the impending decommissioning phase, the emphasis for now is to ensure maximum recovery of the estimated remaining reserves of 16-25 Bboe.[1] It is therefore vital to both government and industry to encourage a high level of exploration and production and the associated corporate activity in the North Sea. The recent government public consultation process further introduced changes to the existing legal requirements for decommissioning.[2] Industry launched a mechanism to deal with the costs of decommissioning and also developed guidelines and standards to assist their members facing decommissioning projects in the UK Continental Shelf (UKCS).[3]

The decommissioning of the 450 offshore installations (and also subsea wells and about 10, 000 km of pipelines, if they are to be removed) has been delayed whilst companies fully exploit the UKCS. However it is accepted that once the phase starts in earnest, the cost of decommissioning of the UK's offshore infrastructure is widely determined as ranging between £15 - 20 billion up to 2030. New and existing industry players have realised the significant investment potential and have accordingly developed a supply chain of contractors and service providers.

The challenge therefore for both the UK industry and government is to find a practical arrangement to balance the need for future investment with appropriate safeguards to cover the huge decommissioning liabilities. It is therefore in everyone's interest to ensure that decommissioning obligations and liabilities are defined clearly and funded properly. The main question relating to decommissioning liabilities is: who should be responsible - government, industry or the taxpaying public?

Government consultation

The main objective of government is to ensure that a balance is maintained between decommissioning liabilities and the protection of taxpayers. Accordingly, the government's view is that industry should bear the costs of removal of their infrastructure at the end of its useful life and not shift the burden on to the UK taxpayer.

Basically, section 29 of the Petroleum Act 1998 allows the Department of Business and Regulatory Reform (BERR) (the regulatory authority on decommissioning of energy installations in the UKCS) to serve a notice on various parties for the submission of a decommissioning programme.[4] The parties are jointly and severally liable to carry out the programme and, if they fail to do so, BERR can carry out the decommissioning work and charge them accordingly. Section 29 notices are usually issued to the licensees on development approval requiring the submission of the programme at a date to be notified later, usually 3 years before Cessation of Production (COP). A number of persons are liable for the submission of the decommissioning programme including the operator (the person having the management of the installation), the licence holder (the person who has a right to exploit or explore for the oil and gas), parties to the joint operating agreement (may differ from licensees), persons who own any interests in the installation other than as security (e.g. bank) and a company which is associated with one of the above. In terms of the Act, BERR can also claw back into liability anyone on whom a section 29 notice could have been served at any time after the first notice was served including previous licence holders.[5]

BERR have launched a consultation on the changes to the offshore decommissioning regimes for oil and gas installations under the Petroleum Act 1998 and for renewable energy installations under the Energy Act 2004. The objective of the consultation is to strengthen the government's ability to require, and the operators' ability to safeguard, appropriate financial security for the costs associated with the

decommissioning of offshore facilities. According to BERR, the aim is to minimise the risk that companies default on their obligations leaving the government to meet the costs whilst continuing to encourage the necessary investment in the sector.[6] The proposed changes cover the following issues:

- the safeguarding of decommissioning funds; the widening of the categories of persons on whom decommissioning obligations can be placed (including associates of Limited Liability Partnerships); the provision for earlier issue of notices and earlier provision of decommissioning security; access to information; and the potential for cross-industry co-operation and collaboration.

The consultation closed on 13 September 2007 and BERR is currently reviewing the comments that will be included in a formal government response together with the introduction of new legal changes to parliament towards the end of this year and final adoption during next year.

Industry initiatives

The general view from industry is that the issue of decommissioning liabilities (including the enormous costs) should not be seen as a barrier to the entrance of new and smaller companies and the transfer of North Sea assets, which are important to the current state of the UKCS, particularly for mature fields heading towards the late stage of their productive lives. The industry body, Oil and Gas UK (OGUK) has stated that the long-term future of the North Sea depends upon recovering the remaining UK oil and gas reserves and therefore any uncertainty concerning the fiscal and regulatory regime for decommissioning would delay the necessary asset transfers and subsequent opportunities for incremental investment.

Over the last three years, industry has been developing a standard decommissioning securities arrangement to improve the negotiations between the joint venture partners and government. The benefits of the arrangement are to reduce the cost of providing securities, remove duplication and ensure that provisions are appropriate and tied to cost guidelines. This arrangement, which has been named the Decommissioning Cost Provision Deed (DCPD), was launched at an Oil and gas UK seminar on 26 September 2007 in Aberdeen.[7] The DCPD is now regarded as the new industry standard agreement for use by joint venture partners in UK offshore oil and gas assets to ensure appropriate provisions are in place to cover each company's share of future decommissioning costs. It is widely regarded as an important step towards the management of joint obligations on decommissioning liabilities consistent with the goal of maximising recovery of UKCS oil and gas reserves. It was also stated that the government generally supports industry's initiative as long as it protects taxpayer from industry's liabilities and reduces the security cost impact and the government generally encourage alternative securities including the industry DCPD.[8]

The DCPD is to be used as a template form of agreement between the member companies for providing for the costs of decommissioning. The deed is entered into on a voluntary basis and is used in conjunction with the Joint Operating Agreement (JOA). It could also be used as part of the security arrangement during the buying or selling of an interest in any asset. It is designed as a standard that applies to a field rather than single interests but could be adapted for that use. The DCPD includes clauses on

- the objects; the determination of the decommissioning plan; the establishment of a trust; the licensee's share of the cost of decommissioning; default; the payment of decommissioning costs; the assignment and withdrawal; expert resolution; confidentiality; notices; third parties and finally miscellaneous provisions (including the applicable law which is English law).

The document also contains templates for a Trust Deed in respect of the payment of the decommissioning costs (for use between licensee, operator and trustee); Deed of Adherence (to be executed as a deed by each new second tier participant); and a form of a letter of credit for estimating decommissioning costs (for banks and agents). At the moment, the DCPD is still under development and it is therefore up to the members to shape it along the way to fit in with individual circumstances. OGUK is however convinced that its robust legal structure and flexible application will encourage adoption across the industry. It is intended to speed implementation and reduce duplication of securities arrangements. It should be an important contribution in establishing appropriate decommissioning

provisions and help boost asset trading on the UKCS. Further work by industry on decommissioning includes:

- The PILOT^[9] arrangement which aims at decreasing decommissioning uncertainty, reducing the impact on asset trading and further development investments through: the introduction of the standard DCPD with wider financial guarantee options; standardisation for cost estimating and contracting and the adoption of guidelines and mechanisms for best practice in decommissioning; and
- The LOGIC^[10] Standard Contracts Committee (made up of operators and contractors) which is also developing a contractual regime dealing with decommissioning, which would be in the form of a standard contract for decommissioning or a set of guidance notes, designed to streamline the contractual aspects of the decommissioning process. It is envisaged that this arrangement would address the key risks (*e.g.* structural integrity, presence of hazardous materials, risk of environmental damage) and revise and analyse the existing standard clauses on indemnity and liabilities.

Conclusion

Finally, from the above, it is clear that government and industry have been working closely together in improving the regulatory regime concerning the issue of decommissioning to create a robust financial security agreement for all parties involved in decommissioning. Both parties have been tackling the issues in an open, consultative and transparent manner with the aim of decreasing the uncertainties surrounding the impending decommissioning 'boom'.

[] Dr Leon Moller is an energy, oil and gas lawyer, specialises in the decommissioning of offshore installations and holds a PhD (University of Dundee) in international law of the sea and the exploitation of offshore oil and gas resources.*

[1] See Scottish Enterprise, *Spends & trends 2007 –UCS, A Forecast Report on Capital Expenditure in the UKCS oil and gas market, 2007*, www.scottish-enterprise.com/energy (10/07).

[2] See Decommissioning of Offshore Energy Installations, a DTI (now BERR) consultation document, <http://www.og.dti.gov.uk/consultations/index.htm> (10/07). The consultation concerned changes to the offshore decommissioning regimes for oil and gas installations in the Petroleum Act 1998 and for renewable energy installations in the Energy Act 2004.

[3] For a copy of the Decommissioning Cost Provision Deed (DCPD) see Oil & Gas UK website at <http://www.oilandgasuk.co.uk/issues/decommissioning/index.cfm> (10/07).

[4] See the Petroleum Act 1998 at Government Office of Public Sector Information (OPSI) at <http://www.opsi.gov.uk/acts/acts1998/19980017.htm> ((10/07).

[5] See section 34 of the Petroleum Act 1998.

[6] Presentation by Keith Mayo, Head of Offshore Decommissioning, BERR (formerly DTI) at the OGUK Decommissioning Seminar, 26 September 2007, AECC, Aberdeen.

[7] See note 3.

[8] See note 6.

[9] The PILOT is a joint programme involving the Government and the UK oil & gas Industry (including the Operators, Contractors, Suppliers, Trade Unions and SME's) aiming to secure the long-term future of the Industry in the UK. It succeeded the Oil & Gas Industry Task Force (OGITF) which was established in 1998 to address the dramatic fall in oil prices, the maturing of the UKCS, and the urgent need to reduce the costs of operating in the North Sea. See Pilot website at <http://www.pilottaskforce.co.uk/> (10/07).

[10] LOGIC (Leading Oil and Gas Industry Competitiveness) was created in 1999 by the government's Oil & Gas Industry Task Force (now PILOT) to stimulate supply chain collaboration and improve the competitiveness of the UK Continental Shelf. LOGIC is a not-for-profit, wholly-owned subsidiary of Oil & Gas UK. See LOGIC website at <http://www.logic-oil.com/> (10/07).